Supreme Court, U.S.
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No. 94-290

IN THE
**SUPREME COURT of the UNITED STATES**
OCTOBER TERM, 1994

STATE FARM FIRE AND CASUALTY COMPANY,
*Cross-Petitioner,*

v.

RICHARD MITCHELL AND LARRY COTTEN,
*Cross-Respondents.*

**On Cross-Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit**

# CROSS-RESPONDENTS' BRIEF IN OPPOSITION

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## QUESTION PRESENTED

Whether the United States Court of Appeals for the Tenth Circuit correctly declined to direct the district court to dismiss Cross-Respondents' claim of breach of good faith and fair dealing in view of the jury's finding of damages and the evidence in support thereof, flowing from State Farm's tortious conduct.

## STATEMENT REGARDING PARTIES TO THE PROCEEDING

The names of all parties to the proceeding in the court whose judgment is sought to be reviewed appear in the caption of this Petition. Pursuant to Supreme Court Rule 29.1, Cross-Respondents Richard Mitchell and Larry Cotten state that they are individuals and that such Rule therefore does not apply to them.

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## STATEMENT OF THE CASE

The jury found that the evidence fully supported Cross-Respondents' claim that State Farm breached its duty of good faith and fair dealing. State Farm's recitation of the facts of this case ignores the evidence supporting Cross-Respondents' claim and draws unsubstantiated inferences from the evidence. Accordingly, pursuant to Supreme Court 15.1, Cross-Respondents must set forth the facts below.

On December 7, 1981, Cross-Respondents Larry Cotten and Richard Mitchell purchased a four-unit condominium complex ("the property") in Crested Butte, Colorado from the Pokress family for $255,000. At the time Cross-Respondents purchased the property, it was insured by the Pokress family with the Cross-Petitioner, State Farm Fire and Casualty Company, under an apartment policy ("the policy") for $278,300. State Farm consented to an assignment of the policy from the Pokress family to Cross-Respondents.

In May 1982, Mitchell and Cotten obtained a $385,000 line of credit loan ("the loan") from an Arkansas bank, to draw against as needed to pay operating expenses, interest payments and ultimately remodeling expenses on the property. The loan was secured by a deed of trust on the property. As required by the terms of the loan documents, Cross-Respondents arranged with State Farm to add the bank to the policy as an additional insured and loss payee.

From May 1982 through April 1985, Cross-Respondents drew down against the loan as monies were needed for the property. Contrary to State Farm's insinuation of improper use of the loan monies, the bank never disputed Cross-Respondents' expenditures of the funds.

Despite State Farm's efforts to imply that Cross-Respondents were responsible for overinsuring the property,

the evidence shows that State Farm knowingly overinsured the property for amounts it would never pay. Whenever the loan balance exceeded the insurance coverage provided by State Farm, Cross-Respondents were obligated by the bank to obtain additional insurance coverage to protect the bank's security interest in the property. In order to satisfy their obligations to the bank in each instance the loan balance increased, Mitchell and Cotten called the State Farm agent, John O'Shea, and explained that they needed to increase the insurance coverage on the property because the balance on the loan had increased and they needed to ensure that their lenders were fully protected. Each time Cross-Respondents made such a request, State Farm agreed and increased the insurance coverage and corresponding premium without disclosing that it would refuse to pay the increased face amount of the policy in the event of a total loss. State Farm's failure to advise Cross-Respondents that they were overinsuring the property was contrary to the duty of an insurance company (identified by State Farm's own expert, J. Kent Miller) to tell its insured when it knows the insured is overinsuring its property.

On November 4, 1983, Mr. O'Shea determined that the replacement cost for the property was only $158,723. However, State Farm never communicated this conclusion to Cross-Respondents. Instead, State Farm continued to increase the insurance and collect the ever-increasing premiums. By May 1985, State Farm had increased the insurance on the property to $450,000, almost three times the replacement cost determined by Mr. O'Shea.

On May 26, 1985, the property was totally destroyed by an arson fire and State Farm instigated an investigation shortly thereafter. Cross-Respondents have never disputed that State Farm was entitled to reasonably investigate their claim to determine whether the insured caused the loss.

Cross-Respondents' claims in this case arose when State Farm crossed the line of reason and breached its duty of good faith and fair dealing.

State Farm's investigation was intended to establish an arson defense to Cross-Respondents' claim. State Farm assigned two adjusters (John Melander in Colorado and Bob Willson in Arkansas) to determine whether Cross-Respondents were involved in causing the fire. In furtherance of this assignment, Mr. Willson took extensive recorded statements of Cross-Respondents on June 25, 1985, which lasted for approximately three hours each. It is undisputed that Mr. Willson was thorough, that he was given a full and fair opportunity to ask any and all questions he deemed appropriate, and that Cross-Respondents fully answered every question.

On July 16, 1985, Cross-Respondents' provided State Farm with their sworn statement in proof of loss in accordance with the terms of the policy. On July 19, 1985, State Farm concluded that Cross-Respondents were experiencing financial difficulties with respect to the property at the time of the fire, but were otherwise financially solvent.

Despite State Farm's continued efforts to imply Mitchell and Cotten were responsible for the fire, no evidence was adduced that Mitchell or Cotten had anything to do with the fire, and State Farm admitted that it could not establish that Cross-Respondents committed arson. On August 13, 1985 State Farm re-confirmed what it already knew, that Cross-Respondents were in Arkansas at the time of the fire. By September 1985, State Farm knew or should have known that it could not prove the arson defense. Cross-Petitioner, however, continues to imply, even today, that Mitchell and Cotten were somehow responsible for the fire.

In addition to the aforementioned evidence on the overinsurance, Cross-Respondents presented the jury with numerous other instances of State Farm's bad faith. Some of the facts establishing that State Farm breached its duty of good faith and fair dealing to Cross-Respondents are as follows:

1. On June 7, 1985, approximately ten days after the fire, State Farm hired a lawyer, Mary Wells, to aid it in "direction toward an investigation leading to possible litigation;"

2. On September 16, 1985, Ms. Wells accusatorially examined Mr. Cotten for five hours, and Mr. Mitchell for two hours, asking many, if not all, of the same questions asked by Mr. Willson three months earlier, including by way of example and not limitation, questions regarding Cross-Respondents' possible involvement in criminal activity (arson) and questions regarding Cross-Respondents' personal lives and financial condition;

3. On October 3, 1985, State Farm notified Cross-Respondents that the policy was going to be canceled if Cross-Respondents did not pay the premium, even though the property had been totally destroyed by fire four months earlier;

4. From October 1985 through the filing of this action, Mr. O'Shea ignored Cross-Respondents' requests for assistance in the processing of their claim with State Farm;

5. On October 25, 1985, State Farm finally paid the Pokress family the remaining indebtedness of $113,164.18. However, State Farm did not discharge the debt of Cross-Respondents by releasing the deed of trust encumbering the property. Instead, State Farm took an assignment of the first deed of trust on the property, stepping into the shoes of the

first lien holder with the threat of possible foreclosure against Cross-Respondents. State Farm did not release this deed of trust until December 1987, eighteen months after the lawsuit was filed;

6. On November 19, 1985, Ms. Wells agonizingly examined Mr. Mitchell for an additional four hours, asking many of the same questions asked by Mr. Willson on June 25, 1985 and by Ms. Wells on September 16, 1985.

Cross-Respondents' expert, Garth Allen, a professor of insurance at the University of Northern Colorado and Executive Director of the Colorado Insurance Education Foundation, was qualified by the trial court as an expert witness in the area of insurance industry practices and procedures. Professor Allen testified that, based on his review of the historical relationship between State Farm and Mitchell and Cotten, and based on the information generated during State Farm's handling of Cross-Respondents' claim, State Farm acted unreasonably in delaying Cross-Respondents' claim. He further testified that State Farm knew that its conduct was unreasonable.

After enduring 14 months of State Farm's unreasonable conduct and refusal to pay benefits, Mitchell and Cotten filed suit on July 10, 1986. On April 30, 1992, nearly six years later, the jury concluded from its review of all the evidence presented that State Farm breached its duty of good faith and fair dealing. The jury found the compensatory damages resulting from the tort to be $256,000. Since the jury also found *beyond a reasonable doubt* that State Farm's tortious conduct was "attended by circumstances of insult or a wanton and reckless disregard of the rights or feelings" of the plaintiffs, it was permitted to award exemplary damages of $10,000. The jury found in favor of State Farm on Cross-Respondents' claim of breach of contract.

State Farm appealed to the Tenth Circuit Court of Appeals. A panel of the Tenth Circuit vacated the judgment and remanded Cross-Respondents' claim of breach of duty of good faith and fair dealing to the trial court. The panel vacated the judgment because it found the jury verdicts inconsistent. Contrary to Cross-Petitioner's statement of the Tenth Circuit's holding, the Court did not find the verdicts inconsistent because no evidence of $256,000 in damages was introduced. Rather, the court found the verdicts inconsistent because the jury determined that State Farm did not owe Mitchell and Cotten $450,000 under the contract, but found that Cross-Respondents' damages for the breach of duty claim was the difference between $450,000 and the amount State Farm paid to Cross-Respondents' mortgagees.

Mitchell and Cotten submitted a Petition for Rehearing and Suggestion for Rehearing In Banc to the Tenth Circuit. A panel of the Tenth Circuit denied the Petition. Once again, Cross-Petitioner misstates the holding of the Tenth Circuit. Contrary to State Farm's assertions, the court did not find that the jury verdicts were inconsistent because Cross-Respondents did not introduce evidence of $256,000 in damages. Rather, the court determined that the jury was not instructed that Cross-Respondents' claim of breach of good faith and fair dealing was based on unreasonable delay and that delayed payment was not synonymous with overinsurance or misleading conduct.

## REASONS FOR NOT GRANTING THE CROSS-PETITION

### A. The Basis For Cross-Petitioner's Petition Is Not Within The Character Of Reasons Set Forth In Supreme Court Rule 10 For Granting Certiorari.

While Supreme Court Rule 10 neither controls nor fully measures the Supreme Court's discretion to grant certiorari, it

does indicate the character of the reasons that will be considered by the Court. Such reasons include decisions of federal courts of appeals that conflict with decisions of sister courts, decisions that determine federal questions in a way that conflicts with a state court of last resort, and decisions on important questions of federal law which should be decided by the Supreme Court or which conflict with other decisions of the Supreme Court. State Farm's Cross-Petition does not set forth any reason, let alone a "special or important reason," why the Supreme Court should grant certiorari of this Cross-Petition.1/

Mitchell's and Cotten's petition for certiorari, on the other hand, sets forth special and important reasons for the Court to grant certiorari. First, the Tenth Circuit's decision on Mitchell's and Cotten's right to trial by jury conflicts with applicable Seventh Amendment decisions by the Supreme Court. Second, by improperly considering State Farm's contention that the jury verdicts were inconsistent, the Tenth Circuit so far departed from the usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. Both reasons for granting certiorari are firmly contemplated by Supreme Court Rule 10. Accordingly, the Court should grant Mitchell's and Cotten's petition for certiorari, and deny State Farm's Cross-Petition.

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1/ Under Supreme Court Rule 13.5, this Cross-Petition for certiorari cannot be granted unless the Petition for Writ of Certiorari is granted because Cross-Petitioner filed its Cross-Petition pursuant to Supreme Court Rule 12.3 more than ninety days after the Court of Appeals for the Tenth Circuit denied Cross-Respondents' Petition for Rehearing.

**B. The Supreme Court Should Not Grant Certiorari On This Issue Because It Cannot Grant The Relief Requested Without Invading The Province Of The Jury.**

Cross-Petitioner essentially argues that the Tenth Circuit erred in not reversing and ordering Cross-Respondents' claim for breach of good faith dismissed because one of the elements of the claim was not proven. The district court instructed the jury that:

> In order for the plaintiffs to recover from the defendant on their claim of breach of duty of good faith and fair dealing, you must find *all* of the following have been proved:
>
> 1. The plaintiffs incurred damages;
>
> 2. The defendant acted unreasonably in delaying payment of plaintiffs' claim without a legitimate basis for said delay; . . .

(Pet. App. J at 3j) (emphasis added). After hearing the evidence, the jury concluded that Mitchell and Cotten proved all of the elements of their breach of good faith claim. The jury necessarily determined that Mitchell and Cotten had proven that they incurred damages as a result of State Farm's breach of duty. As set forth below, the evidence supports the verdict. Therefore, neither the Supreme Court nor the Tenth Circuit may usurp the fact-finding role of the jury. *Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines, Ltd.*, 369 U.S. 355, 358-59 (1962).

**C. The Evidence In The Record Supports The Jury's Verdict That Mitchell And Cotten Suffered Damages As A Result Of Cross-Petitioner's Breach Of Good Faith And Fair Dealing.**

The trial court properly instructed the jury that:

> If you find in favor of the plaintiffs Richard Mitchell and Larry Cotten on their claim of breach of duty of good faith and fair dealing, you shall award as their actual damages, insofar as they have been proved by a preponderance of the evidence and insofar as they were caused by the defendant's breach of its duty of good faith and fair dealing, an amount which will reasonably compensate the plaintiffs for their damages, if any.
>
> In determining such damages, you shall consider any economic losses incurred to the present time, including the difference between the amount you determine should have been paid under the policy of insurance and the amount the defendant has paid, not to exceed in the aggregate the amounts of liability under the insurance contract.

(Pet. App. J at 4j). The jury awarded Cross-Respondents $256,000 as compensatory damages on their claim of breach of duty of good faith and fair dealing.

Damages resulting from an insurer's breach of its duty of good faith and fair dealing "arise from tort and are not restricted to the enumerated benefits [in the policy] but include consequential damages and emotional distress." *Williams v. Farmers Ins. Group, Inc.*, 781 P.2d 156, 159 (Colo. App. 1989), *aff'd*, 805 P.2d 419 (Colo. 1991) (citing *Farmers Group, Inc. v. Trimble*, 658 P.2d 1370, 1375 (Colo. App. 1982), *aff'd*, 691 P.2d 1138 (Colo. 1984)). Moreover,

> An insured injured by [an insurer's breach of its duty of good faith and fair dealing] is entitled to recover damages based upon traditional tort principles of compensation for resultant injuries actually suffered, including emotional distress, rather than upon concepts derived from contract law.

*Farmers Group*, 658 P.2d at 1375. "A breach of [the duty of good faith and fair dealing] renders the insurer liable for damages naturally flowing from the breach." *Schultz v. Allstate Ins. Co.*, 764 F. Supp. 1404, 1409 (D. Colo. 1991).

The evidence at trial showed that Cross-Respondents suffered damages as a result of State Farm's breach of the duty of good faith and fair dealing. Cross-Respondents, for example, lost business opportunities for the property during State Farm's unreasonable delay and suffered emotional distress. Additionally, there is evidence that the purpose of Cross-Respondents in obtaining additional insurance was to pay the bank and have the bank loan covered in the event of a loss. Mr. O'Shea knew that was the purpose for obtaining insurance. (Pet. App. I at 2i-3i.) Mr. O'Shea also knew, but never disclosed to Mitchell and Cotten, that State Farm would take the position that it only had to pay the replacement value and had an appraisal setting the replacement value at $158,723, well below the insured value. Mitchell and Cotten were damaged because they could have obtained additional insurance to cover the loan balance had State Farm dealt with them fairly and in good faith. Because of State Farm's unreasonable conduct, Mitchell and Cotten remained liable on the bank's loan with interest continuing to accrue. In light of State Farm's conduct, the jury must have found that State Farm had no legitimate basis for delaying payment of benefits which Cross-Respondents believed they were purchasing.

Consistent with the claims being advanced, Cross-Respondents agreed to limit their compensatory damages on the claim of breach of duty of good faith and fair dealing to the difference between what State Farm should have paid based upon what State Farm's agent, Mr. O'Shea, had represented the policy limits to be in the event of a total loss ($450,000) and the amount it did pay ($194,000). Cross-

Respondents simplified the claim for the jury and provided a rational and logical argument in support of their damage claim based upon the evidence presented.

It was within the province of the jury to award Cross-Respondents compensatory damages based upon the evidence presented at trial. In fact, it is obvious from several questions asked by the jury during its deliberations that the obligation to the bank was at least one of the bases for its damage award. (Reply App. A at 2a-4a.) Because there is sufficient evidence in the record to support the jury's verdict, the verdict should not be disturbed. *Mercer v. Theriot*, 377 U.S. 152, 155 (1964).

## CONCLUSION

While Mitchell's and Cotten's petition for certiorari raises important Seventh Amendment issues, this Cross-Petition raises no such concerns. In fact, the Cross-Petition evidences an effort by State Farm to further disregard the jury's findings and deprive Mitchell and Cotten of the jury trial it took six years to get. Because there are no special or important reasons for granting this Cross-Petition for certiorari, it should be denied.

Respectfully submitted,

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